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September 12, 2000

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Securities
and Government Sponsored Enterprises
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Baker:

The Mortgage Bankers Association of America (MBA) is pleased to have the opportunity to supplement our oral and written testimony of July 20th on H.R. 3703, the Housing Finance Regulatory Improvement Act. We are responding to your invitation to provide an executive summary of the topics that we hope to discuss at the roundtable discussion the Capital Markets Subcommittee will hold in September on Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (the housing GSEs or the Enterprises).

MBA reiterates our appreciation for the Subcommittee's leadership in addressing the appropriateness of the current regulatory regimes governing the Enterprises. The focus of our earlier testimony was that the housing GSEs require strengthened regulation. We support the basic approach of H.R. 3703 because of its objective of strengthened oversight of Fannie Mae and Freddie Mac.[1] Our position may be summarized as follows:

- MBA believes the private/public partnership established in this country to foster affordable mortgage credit is uniquely successful and should be preserved. Under this system, Fannie Mae and Freddie Mac provide needed liquidity to private lenders in the residential mortgage market while receiving a variety of highly valuable operational advantages.

- MBA believes that – to achieve the most efficient delivery of the lowest cost residential mortgage credit – there must be a robust and resilient primary mortgage market consisting of private market lenders. Competition among them is key to developing innovative products to meet borrowers' needs, as well as to lowering borrowers' costs.

[1] This letter does not address the regulation of the Federal Home Loan Banks.

- MBA believes that, to uphold those first two principles, we need to assure effective oversight of the Enterprises. Effective oversight can help address the issues of safety and soundness and systemic risk. In addition, independent and well-funded oversight can help to maintain the vitality and the robust nature of the primary market by preventing expansion of GSE activities beyond the intended boundaries of their Federal charters.

- MBA believes that regulation of the GSEs must be independent and well-funded. It must be carried out by an entity, or entities, with the resources and expertise to evaluate the GSEs' performance, both as financial institutions and as public purpose entities. Such a regulatory structure must have the capacity to enforce its findings. Costs of this regulation should be fully funded by the GSEs themselves. However, merely creating a single regulator or changing the home of OFHEO to the Treasury Department, as has been discussed, without providing the foregoing resources and clarifying the boundaries of the Enterprises' charters, would not adequately further overall Enterprise oversight.

- MBA believes that, in order to be effective, H.R. 3703's "new activity review" process needs to include a clear standard against which a regulator can measure whether an Enterprise would be expanding its activities beyond the boundaries intended by Congress. This can be readily achieved by defining the "secondary market for residential mortgages" as used in the Enterprises' charter acts. With the mortgage business quickly evolving as a result of technological innovation and the development of new business paradigms, the inquiry of whether the Enterprises are operating within the intent of Congress is ever more appropriate.

- The "new activity review" process needs to include a procedure for establishing "safe harbors" from notice and comment rulemaking for certain classes of activities.

We will discuss our definitional and safe harbor recommendations in more detail below.

Need for Definition of the "Secondary Market for Residential Mortgages"

Current law does not define the domains of Fannie Mae or Freddie Mac with specificity. The Enterprises' charter acts refer to the "secondary market for residential mortgages" in their statements of Enterprise mission as follows:

[Each was established]:

(1) "to provide stability in ***the secondary market for residential mortgages***;
(2) to respond appropriately to the private capital market;
(3) to provide ongoing assistance to ***the secondary market for residential mortgages*** (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and
(4) to promote access to mortgage credit throughout the Nation, including central cities, rural areas, and underserved areas, by increasing the liquidity of mortgage investments and

> improving the distribution of investment, capital available for residential mortgage financing (emphasis added)."

The term "secondary market for residential mortgages" is not defined in the respective charter acts of the Enterprises. Lack of a clear definition provides the Enterprises with the opportunity to expand their activities– arguably beyond what Congress reasonably intended by their mission to provide liquidity to the primary mortgage market.

The special statutory advantages the Enterprises enjoy would permit them an unfair competitive advantage in any activities outside their intended mandate. Accepted economic theory would argue that the Enterprises would dampen competition and innovation in the primary market. Congress recognized in the charter acts through prohibitions against direct lending to borrowers and interim lending that the primary market is not the appropriate domain of the Enterprises. However, the current ambiguity as to the bounds of their secondary market functions allows blurring of the lines between the two spheres. For example, when the Enterprises attach conditions on the deployment of their technologies, build brand identification with consumers, and invest in primary market service providers, their activities have direct impact on primary market participants. Although the immediate casualties of Enterprise incursions into the primary market might be existing mortgage providers, we believe consumers will be the ultimate losers. Less competition means higher borrowing costs and fewer financing options over the long-term.

At this juncture in the legislative process and in the evolutionary process of residential mortgage lending, MBA believes the enactment of a "bright line" test would significantly help a regulator to exercise its oversight role and thereby help to reduce uncertainty as to what activities are within the Enterprises' domain--a regulator needs to understand clearly the scope of its authority. A clear definition of the boundaries of the secondary market, combined with intelligent and independent regulatory authority, would promote innovation and competitiveness in the primary market to the benefit of consumers and the entire real estate financing system. The elimination of the uncertainty that characterizes the current oversight system would inure to the benefit of all parties, the Enterprises, primary market lenders, mortgage investors, Congress, the regulators, and consumers. In short, we need to replace ambiguity with clarity.

MBA is currently involved in a process to develop a workable definition of the appropriate domain of Fannie Mae and Freddie Mac. As we noted in our testimony in July, we have agreed with the Enterprises to engage in a dialogue on this definitional issue before we submit a recommendation to you. We will keep you apprised of our progress.

The MBA is pleased to provide the Subcommittee with the attached memorandum of law regarding the meaning of "secondary market for residential mortgages." The memorandum surveys the charter acts and other relevant law as well as readily available legislative history.

Safe Harbor from Notice and Comment Rulemaking

The MBA proposes that Section 1322 of the Bill be amended to authorize the regulator to exclude actions from the new activity review procedures through a rulemaking process.

Although MBA believes it is appropriate and desirable for the Enterprises' activities to be reviewed by its regulator(s), there are classes of activities for which a prior approval process involving a notice and comment rulemaking procedure would be inappropriate. Lenders, and the Enterprises *within the scope of their mission*, must be free to innovate in order to allow lenders to deliver the most affordable mortgage credit to consumers.

Currently, lenders compete to deliver product innovations to market through a confidential process of negotiation with an Enterprise. To facilitate this process, regulation must proceed in a way that distinguishes between truly new initiatives and incidental modifications to existing products or activities. The latter should be able to proceed, unimpeded, in the normal course of business.

Some examples of the kinds of activities that are contemplated to be excluded from the prior approval process are authorizations by an Enterprise to allow a lender to deliver products with: i) innovative schedules for remitting principal and interest, such as the biweekly mortgage; or ii) relaxed underwriting or documentation requirements under specific circumstances.

* * * * *

Thank you again for the opportunity to comment on these important matters. Pleases call Howard Glaser at 202-557-2904 if you have any questions.

Sincerely,

_____
Howard Glaser

Attachments

cc: The Honorable Paul Kanjorski
2353 Rayburn House Office Building
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